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Minijob-reform: No Effect on Unemployment, Losses in Income Tax and Social Security Contributions

Viktor Steiner and Katharina Wrohlich

The so-called 'Minijob-reform', that was introduced in April 2003 as part of the 'Hartz II'-reform, was intended to increase work incentives for people with low wages and thereby reduce structural unemployment. Therefore, the hours restriction of 15 hours per week was abolished and the threshold up to which earnings remain free of social security contributions (SSC) was increased.

We calculate the labor market effects and the effects on income tax and SSC on the basis of a micro simulation model. The analysis also includes indirect effects on total income tax and SSC resulting from the labor market effects of the reform. These effects consist of both, the effects from people not employed before the reform and the effects from people who were already working before the reform and whose labor supply reactions mostly remain disregarded in the political debate.

The estimations show that the 'Minijob-reform' led to a small increase in the number of people in marginal employment. The effects on employment in secondary jobs and the potential legalization of illicit work are, however, not taken into account in this analysis. Persons who have already been working before the reform reduce their working hours. This leads to a small decrease in total working hours throughout the population.

Labor market effects

The labor market effects of the 'Minijob-reform' crucially depend on the resulting changes in work incentives (see box). The estimation presented here is based on a micro simulation model, which embeds a micro-econometric household labor supply model.¹ This model is based on data from the Socio-Economic Panel (SOEP), which is collected by DIW Berlin in cooperation with Infratest Sozialforschung.

¹ For a detailed description of the model and estimation results, see Viktor Steiner and Katharina Wrohlich: "Work Incentives and Labor Supply Effects of the 'Minijob-reform' in Germany". *DIW Discussion Paper*, no. 438. Berlin 2004.

Work incentives of the 'Minijob-reform'

Subsidies to Social Security Contributions (SSC) already existed before April 2003 for so-called marginal employment (*'geringfügige Beschäftigung'*). Up to a threshold of euro 325 per month, salaries were exempt from employee's SSC and income tax. Above this threshold, contributions and income tax were due on the whole amount of earnings, leading to high effective marginal tax rates above euro 325. This made employment at low wages above this threshold financially unattractive.

The reform increased the threshold of euro 325 to euro 400 (so-called 'mini-jobs') and introduced subsidies to SSC for salaries between euro 401 and euro 800 (so-called 'midi-jobs'). Above euro 400, employees' SSC amount to 4% of the salary and increase linearly until they reach the regular 21% for salaries of euro 800. Additionally, the hours restriction of 15 hours per week as a prerequisite for eligibility to subsidies was abolished. Income tax fully sets in at euro 400, similar to before the reform, when it set in at euro 325. Employers have to pay SSC of 25% of the salary for all minijobbers, which includes a 2% lump-sum income tax. For salaries above euro 800, employers pay the regular rate of 21% of SSC. Employers who are private households have to pay SSC at a reduced rate of 12%. The intention of this measure was to reduce illicit work in private households. In order to boost the demand for services by private households even further, the expenditures for SSC for these kind of jobs can be deducted from the income tax of the household.

The work incentives of this reform have to be distinguished for several different groups:

- Work incentives increased for people who are not eligible for transfers such as unemployment benefits or social assistance. Since this group of people largely consists of secondary earners in couple households, the incentives for taking up a job with a salary higher than euro 400 are weak, due to the joint income taxation of married spouses in Germany.
- Work incentives for people receiving unemployment benefits or social assistance have hardly been changed by the reform, since withdrawal rates of these transfers have not been altered. The average unemployment benefit amounts to euro 720 per month, whereas a 'midijob' at euro 800 leads to a net income of euro 650 per month. Thus, taking up these jobs is still financially unattractive for unemployment benefit receivers. According to the legislation up until the end of 2004, income above euro 165 per month was fully withdrawn for people receiving unemployment benefits. Since this amount even lies below the subsidy threshold before the 'Minijob-reform', work incentives for this group have not changed. However, there might be changes due to the so-called 'Hartz IV' reform, which was introduced in January 2005. This reform changed withdrawal rates for receivers of unemployment assistance to about 70%.¹
- Students and pensioners might profit from the reform. The increase of the threshold up to which salaries remain exempt from SSC will probably lead to a higher employment in these groups.
- Negative incentives can be expected for working people with salaries just above euro 800. The new subsidies make it financially attractive to reduce working hours. Thus, while there might be a positive participation effect, the effect on total working hours is not clear and can only be assessed on the basis of empirical studies.

¹ Under the new 'Hartz IV' legislation, the withdrawal rates of transfers amounts to 85% up to a monthly salary of euro 400. Between euro 401 and euro 900, 70% are withdrawn, and between 901 and 1800 the withdrawal rate is again 85%. For jobs with a monthly salary of euro 400, therefore only euro 60 remain 'tax-free', in contrast to euro 165 before the 'Hartz IV' reform. Only with a job yielding a salary of euro 751 or more, a person receiving unemployment assistance would gain more in net income than before the 'Hartz II' reform.

The main results can be summarized as follows:

- The effect on the number of employed persons is relatively small and amounts to 53 000 persons (36 000 full-time equivalents; cf. table 1). Since this number is relatively low, we expect that this additional supply can be absorbed by labor demand without change in wages. Therefore, we regard the labor supply effect as equal to the labor market effect.
- Those people who were already employed before the reform reduce their working hours by 1.5 million hours per week (39 000 full-time equivalents).
- Overall working hours are reduced by 79 000 hours per week (about 2000 full-time equivalents). Thus, the positive participation effect and the negative hours effect of those already working cancel each other out.
- The group of people who react most to the reform are part-time working secondary earners, mostly married women. For these people, the reform introduced incentives to reduce working hours by subsidizing SSC for low earnings. On average, the working hours of this group are reduced by 1%.

It is important to stress some of the limitations of our analysis at this point. In this study, only the labor supply reactions of the 'main labor force' is analyzed. Students, pensioners and the self-employed, as well as people in vocational training are not included. It is to be assumed, however, that the 'Minijob-reform' has led to an increase in the employment of these groups.

Furthermore, the possibility of taking up a minijob as a secondary job could not be taken into account. The same applies to the possible legalization of illicit work.

Table 1
Minijob-reform: Labor Supply Effects
 In thousands (rounded)

	Couples		Singles		Total
	Women	Men	Women	Men	
Persons taking up a job after the reform	42 (31 to 52)	9 (7 to 12)	2 (1 to 4)	0	53 (40 to 67)
Change in working hours (per week)	-409 (-829 to 11)	412 (305 to 520)	-82 (-125 to -40)	0	-79 (-127 to -32)
of which:					
Change due to additional employees	957 (727 to 1187)	381 (289 to 474)	58 (30 to 87)	0	1396 (-1044 to 1747)
Change in working hours of those already employed before the reform	-1367 (-1719 to -1014)	31 (13 to 49)	-140 (-253 to -94)	0	-1476 (-1970 to -930)

Numbers in brackets show 95%-confidence intervals.
 Sources: SOEP; DIW Berlin calculations.

There is still no reliable data on this issue. All in all, these limitations may lead to an under-estimation of the positive effects of the reform.

Comparing these results with the numbers that were recently published by the German Labor Office (*Bundesagentur für Arbeit, BA*), at the first sight there appear to be significant discrepancies. The BA statistics show that the number of minijobs rose by 523 000 from March 2003 to March 2004,² which is about ten times the number that we estimate. To a large extent, this difference is due to the fact that our number of 53 000 includes persons additionally employed, whereas the number of the BA includes additional mini-jobs. The BA number includes 241 000 persons who had been working at a monthly salary between euro 326 and euro 400, and whose contract was per definition transferred into a minijob, without any change in working hours.³ Furthermore, the BA's number includes 196 000 persons, who had been working full-time or part-time before the reform and who reduced their working hours after the reform so that they now hold a minijob. Thus, only the remaining 86 000 minijobs are held by persons who were not employed before the reform. Assuming that a third of this group are pensioners and students, these numbers are very close to our estimations of about 50 000 additional employees.

It is to be assumed the effect is larger for people taking up a minijob as a secondary job. According to the BA the number of secondary jobs rose by 850 000

between March 2003 and March 2004. This effect can not be estimated in our study. However, there is evidence that a considerable part of these new jobs are transformations of contracts held by freelancers.⁴

Effects on total income tax and social security contributions

The 'Minijob-reform' also affects total income tax and social security revenues. The total effect consists of two parts: Firstly, there is the effect before any behavioral changes take place. Income tax and SSC changes only due to the new legislation. Secondly, the behavioral changes of households lead to a further change in these revenues, e.g. changes caused by an adjustment in labor supply. Table 2 summarizes the effects on income tax and SSC that are calculated on the basis of the micro simulation model.

As expected, the effect on income tax and SSC without behavioral change is small, but negative. The labor supply effect, which is also estimated based on the simulations, leads to a further reduction in total revenues. All in all, income tax revenues decline by 370 million euro per year, whereas employee's SSC decline by 811 million euro per year.

The change in employer's contributions to social security is not equal to the change in employee's SSC. Employer's contributions are due from the first euro of the salary, therefore the loss in employer's contributions

² See Bundesagentur für Arbeit: 'Mini- und Midijobs in Deutschland'. Sonderbericht. Nürnberg 2004.

³ See Ulrich Walwei: 'Arbeitsmarktwirkungen einer Senkung von Sozialabgaben'. Mimeo, Institut für Arbeitsmarkt- und Berufsforschung (IAB). Nürnberg 2004.

⁴ See Jürgen Schupp and Elisabeth Birkner: 'Kleine Beschäftigungsverhältnisse: Kein Jobwunder'. In: *Wochenbericht des DIW Berlin*, no. 34/2004.

Table 2

Fiscal Effects Based on Micro Simulation

In million euro

	Effect before behavioral change	Effect of behavioral change	Total effect
Change in income tax			
Couples	-244 (-412 to -76)	-105 (-170 to -40)	-351 (-575 to -127)
Single Women	-5 (-10 to -1)	-14 (-21 to -6)	-19 (-28 to -10)
Total	-249 (-398 to -100)	-119 (-180 to -58)	-370 (-554 to -186)
Change in Employee's Social Security Contributions			
Couples			
Men	-2 (-7 to 3)	53 (24 to 82)	52 (23 to 81)
Women	-633 (-771 to -495)	-104 (-160 to -48)	-738 (-907 to -569)
Single Women	-109 (-135 to -83)	-16 (-24 to -8)	-125 (-156 to -94)
Total	-744 (-1494 to 6)	-67 (-99 to -35)	-811 (-1062 to -560)

Numbers in brackets show 95%-confidence intervals.
Source: DIW Berlin calculations.

is less and amounts to about 135 million euro per year. Furthermore, employer's contributions are due for the 53 000 additional employees holding a minijob, which yields an additional revenue of 64 million euro.

There are still no reliable empirical studies on labor supply changes for pensioners and students. Therefore, we roughly estimate the potential effects for this group (cf. table 3). One indicator is the difference between the BA statistic of 86 000 new mini-jobbers and our estimation of 53 000. Assuming that the difference consists of pensioners and students, this presents a group of about 30 000 persons who are not considered in the results presented in table 2. Assuming further, that these persons all hold a minijob with a monthly salary of euro 400, employer's SSC of 33 million euro per year are due for this group, plus 3 million euro lump-sum tax. Thus, the total effect of the additional employment of students and pensioners leads to a small increase in revenues.

The results summarized in table 2 do not include minijobs held as secondary jobs. Since April 2003, employees do not have to pay SSC for wages earned in these jobs. This new legislation leads to two effects: First, contributions for already existing contracts drop out. Second, since the reform has made these jobs financially more attractive, other contracts (e.g. those held by free-lancers) are possibly transferred into secondary minijobs. Referring to the first effect, the IAB (*Institut*

für Arbeitsmarkt- und Berufsforschung) states that losses in contributions amount to about 327 million euro. Estimations of changes in SSC due to the second effect are not available so far.

In order to estimate the total effect on income taxes, revenues resulting from the 2% lump-sum tax also have to be taken into account. According to the BA, there were 4.4 million 'minijobbers' in August 2003. Assuming that all of them receive a salary of euro 400 per

Table 3

Total Fiscal Effects

Effects on...	Million euro per year
Employees' social security contributions (SSC) ¹	-811
Employers' SSC	-130
Income tax ¹	-370
Additional employers' SSC ¹	59
Employers' SSC for additional minijobs by students and pensioners	33
Drop-out of SSC of minijobs as secondary jobs	-327
2 % lump sum tax for all (old and new) minijobs	493
Total	-1053

¹ Based on simulations by Steiner and Wrohlich (2004).
Source: DIW Berlin calculations.

month, the revenue of the lump-sum tax amounts to about 500 million euro per year.

Lastly, there might be a fiscal effect due to the reduction in transfer payments. However, as stated earlier, the incentives for transfer receivers to take up work have not changed. Therefore, no savings are to be expected in this respect.

Table 3 summarizes all the effects described above. As these numbers show, the reform – as it has been analyzed here – resulted in a loss of 1 billion euro in income tax and SSC.

Conclusions for economic policy

As the results from our estimation show, the 'Minijob-reform' did not lead to a large increase in employment: Although there is a small positive effect on participation, this effect is cancelled out by the reduction of working hours by persons who were already employed before the reform. All in all, total labor supply does not change. The fiscal effects of the reform depend on the labor market effects. According to our estimation, income tax and SSC decrease by 1 billion euro. In contrast to what was hoped by politicians, this reform is not self-financed by savings in transfer payments.

The results that are presented here are in line with the statistics on the development of minijobs after the reform. It should be stressed that the statistics published by the BA include minijobs held as secondary jobs, minijobs held by persons who were already employed before the reform, and minijobs held by students and pensioners.

Overall, the 'Minijob-reform' can hardly be seen as a success: firstly, it did not lead to a reduction in unemployment. Secondly, it induced additional costs, as we have shown in our simulations. Our evaluation, however, does not take into account possible positive effects resulting from a legalization of formerly illicit work.